

STATE OF MAINE
PUBLIC UTILITIES COMMISSION

Docket No. 2003-222

May 28, 2003

NORTHERN UTILITIES, INC.,
Application for Approval of Issue
of Securities To an Affiliate
(\$60,000,000) (§ 707, § 901, § 902)

MODIFIED
ORDER APPROVING
ISSUANCE OF
SECURITIES

WELCH, Chairman; NUGENT and DIAMOND, Commissioners

I. SUMMARY

We approve NU's request to modify our May 6, 2003 Order Approving Issuance of Securities to clarify that the interest rate, inclusive of issuance expenses will not exceed 6.50%.

II. ANALYSIS & DECISION

In Docket No. 2001-289, the Commission approved a \$60 million unsecured 2-year note between the Company and NiSource Finance. The purpose of that note was to retire roughly \$51 million in existing long-term and short-term debt. The remainder was earmarked to fund a combination of capital expenditures and/or gas purchases.

On March 28, 2003, Northern Utilities (NU or the Company) filed a request for permission to issue an unsecured promissory note in connection with borrowing \$60 million from its affiliate, NiSource Finance Corporation (NiSource Finance). The term of the note will be 10 years and the interest rate will be fixed by a formula described herein on the date of closing and will not exceed 6.50%. Proceeds will be used to refinance a maturing two-year note between the parties, which the Commission approved on June 5, 2001, in Docket No. 2001-289, *Northern Utilities: Application for Approval to Issue Securities to an Affiliate*, this time on a 10-year basis. The balance sheet of NU will not be more highly leveraged as a result of this transaction, as NU's common equity ratio will be between 58% and 59% of total capital before and after closing (including short-term debt and current maturities of long-term debt). Based on historical industry data, we believe that a 58% common equity ratio is at the higher (and therefore safer) end of the spectrum for natural gas distribution companies today. NU indicates that it could experience a negative earnings impact of as much as \$1.2 million for the fiscal year ending December 31, 2003, if the transaction closes at the maximum interest rate for which it has requested approval, 6.50%. This could occur because the current rate on the expiring two-year note is 5.75%. Given the current level of long-term interest rates, we believe that the Company's request will allow it to lock-in an interest rate that is favorable by historical standards and is worth the risk of lower near-term earnings. Furthermore, as illustrated below, we believe that if NU acts quickly, it has

the ability to lock-in the interest rate on the requested note at a level below 6.50% and perhaps even below the current 5.75% rate.

Due to the inter-company nature of this transaction, we have reviewed the current interest rate market to determine whether or not NiSource Finance has offered NU a "market" interest rate. After consulting with the Company, the Commission Staff concluded (and the Company agreed) that using a rate determined by formula would ensure that this loan would indeed carry a market interest rate. We would not have looked favorably on a situation where NU would have been required to pay a higher rate of interest to an affiliate than would have been available to it through a third-party.

The Company's original filing noted that the parties expected to close the loan in June 2003 at an interest rate not to exceed 6.50% and that doing an inter-company transaction would save NU an estimated \$640,000 in issuance expenses that would have been incurred with a public debt offering. Staff's analysis indicated that 6.50% would have been too high in the current market, even allowing for the yield effect of transactions costs over a 10-year maturity. This was communicated to the Company in a memo dated April 15, 2003, and Staff proposed that the interest rate be fixed at closing using the formula:

End of Week H.15 10-Year Treasury plus 1.75%, not to exceed 6.50%

The H.15 publication is published daily and weekly by the Federal Reserve and shows interest rates on various debt instruments, including most of the usual maturities for treasury securities. The 1.75% credit spread was determined by the sum of the market spread (roughly 1.60%) for 10-year Triple B-rated ("Baa2" for Moody's, "BBB" for Standard & Poor's and Fitch) utilities on that date and the yield effect of \$640,000 in issuance expenses for a \$60 million loan for 10 years (calculated by Staff to be 0.15%). The credit spread for Triple-B utilities was used because both NiSource, Inc., and Bay State Gas currently are rated Triple-B by bond rating agencies.

During a telephone conference on April 17, NU stated that its position was that it had planned to use a similar methodology and that it was not looking to get specific approval of the 6.50% rate, but was rather looking at that figure as a cap. The Company and Staff agreed that since treasury securities and credit spreads fluctuate, it made sense to use the 10-year Treasury Bond plus the appropriate credit spread on the date of closing plus up to 0.15% for issuance expenses, rather than the specific formula proposed in Staff's April 15 memo. **The sum of these three items also would not exceed 6.50%.** If the closing date for this loan was April 25, 2003, and this formula had been applied on that date, the all-in borrowing rate for NU would have been 5.46% based on the H.15's 10-Year Treasury rate of 3.91%, plus the Reuters 10-Year Baa2/BBB Corporate Utility spread of 1.40% (available at BondsOnline.com), plus 0.15%. We note that this rate is lower than the existing rate on the expiring two-year loan, **and is also lower than the 6.50% cap.**

We do wish to highlight one area of concern with this agreement. In our Order approving the NiSource/Columbia merger in Docket No. 2000-322, *Northern Utilities, Inc., Request for Approval of Reorganization: Merger and Related Transaction*, we

specified that we would act to ensure that ratepayers would not be harmed rate-wise following this merger (Order at 9). The NiSource/Columbia merger does have the potential to harm ratepayers specifically as it relates to this agreement. Prior to the NiSource/Columbia merger, Bay State had higher bond and commercial paper ratings than did NiSource. Following the merger, Bay States' ratings were lowered to be on par with those of NiSource due to the fact that NiSource significantly leveraged its balance sheet to fund the Columbia merger. In the near term, this means that NU's interest expenses may be higher than they would have been but for the merger, which would be adverse to the public interest, and thus, would preclude us from approving the proposed agreement. There are, however, mitigating circumstances that allow us to avoid making such a finding. First, NU has not had a rate case in many years, and therefore, the cost of debt associated with this agreement is not actually in the Company's rates today and will not go into rates until after a rate case. Second, as stated in our Order approving the NiSource/Columbia merger, the Company will have the burden of proof in showing that higher borrowing rates resulting from credit rating downgrades were not caused by the merger if it seeks to recover these higher costs in the future. See Docket No. 2000-322, Order at 9. Finally, an approval of the current request is subject to the usual reminder that it will not in any way limit the ability of the Commission to set the rates or charges of the Company in a future rate proceeding. Therefore, we conclude that the proposed arrangement is not adverse to the public interest and approve NU's request.

Accordingly, we

O R D E R

1. That Northern Utilities may issue its promissory note in the amount of \$60 million for a term of 10 years at **an** interest rate **not to exceed the fixed interest rate** determined by the formula described herein to its affiliate NiSource Finance for the purposes described herein.
2. That Northern Utilities file an executed copy of this agreement within 30 days of closing of the transaction.
3. That a copy of the Order be sent to Northern Utilities and this docket be closed.

Dated at Augusta, Maine, this 28th day of May, 2003.

BY ORDER OF THE COMMISSION

Dennis L. Keschl
Administrative Director

COMMISSIONERS VOTING FOR: Welch
 Nugent
 Diamond

NOTICE OF RIGHTS TO REVIEW OR APPEAL

5 M.R.S.A. § 9061 requires the Public Utilities Commission to give each party to an adjudicatory proceeding written notice of the party's rights to review or appeal of its decision made at the conclusion of the adjudicatory proceeding. The methods of review or appeal of PUC decisions at the conclusion of an adjudicatory proceeding are as follows:

1. Reconsideration of the Commission's Order may be requested under Section 1004 of the Commission's Rules of Practice and Procedure (65-407 C.M.R.110) within 20 days of the date of the Order by filing a petition with the Commission stating the grounds upon which reconsideration is sought.
2. Appeal of a final decision of the Commission may be taken to the Law Court by filing, within 21 days of the date of the Order, a Notice of Appeal with the Administrative Director of the Commission, pursuant to 35-A M.R.S.A. § 1320(1)-(4) and the Maine Rules of Appellate Procedure.
3. Additional court review of constitutional issues or issues involving the justness or reasonableness of rates may be had by the filing of an appeal with the Law Court, pursuant to 35-A M.R.S.A. § 1320(5).

Note: The attachment of this Notice to a document does not indicate the Commission's view that the particular document may be subject to review or appeal. Similarly, the failure of the Commission to attach a copy of this Notice to a document does not indicate the Commission's view that the document is not subject to review or appeal.